

1993

# Managing consulting services : a focus on profitability; Consulting services practice aid, 93-1

American Institute of Certified Public Accountants. Management Consulting Services Division

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**AICPA**

*Practice Administration*

**CONSULTING SERVICES  
PRACTICE AID 93-1**

***Managing Consulting  
Services: A Focus  
on Profitability***

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*Management Consulting Services Division*

## NOTICE TO READERS

This practice aid will be integrated into a manual for consulting services issued by the AICPA and is numbered for this purpose. It is designed as educational and reference material for Institute members and others who provide *consulting services* as defined in the Statement on Standards for Consulting Services (SSCS) issued by the AICPA. It does not establish standards or preferred practices.

Consulting Services Practice Aids continue the series of MAS Practice Aids. The change in the numbering system of these series reflects the change of the division name from Management Advisory Services (MAS) to Management Consulting Services (MCS), rather than the discontinuing of any publications in a series.

Various members of the 1991-92 AICPA MAS Practice Standards and Administration Subcommittee provided information for this practice aid and advised the authors and staff. The subcommittee members are listed below.

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## **PREFACE**

This AICPA practice administration aid is one in a series that addresses administrative and operational aspects of providing consulting services to clients within the environment of a CPA practice. These documents will have value for those practitioners who manage or oversee the operations of a consulting services practice. These documents will also be useful to anyone providing consulting services as a CPA, whether as a sole practitioner or a partner or a staff person in a single- or multiple-office CPA firm.

The information provided in this series may not be directly applicable in every circumstance because the nature, organization, and operation of consulting services practices vary considerably. Professional judgment should be used to apply the appropriate concepts or practices described in these documents to meet the administrative or operational requirements of a specific consulting services practice.

These practice aids do not establish binding standards or preferred practices. However, consulting services practice is subject to the binding Statement on Standards for Consulting Services (SSCS). Consulting services practice administration as discussed in these documents may include quality control matters as well as practice management matters.

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**6/100            MANAGING CONSULTING SERVICES: A FOCUS ON PROFITABILITY****6/105    SCOPE OF THIS PRACTICE AID**

**.01**    The purpose of this practice aid is to describe the management processes, decisions, and controls that are needed if a CPA firm is to profit from its consulting services activities. This practice aid will be helpful to practitioners who are responsible for ensuring the profitability of a consulting services practice. It will also be useful to practitioners who are considering developing such a practice, enlarging or formalizing an existing consulting function, or investing in the development of a new line of consulting services and products. The firm's investment in consulting services may range from allocating a portion of a single practitioner's time to maintaining a separate division staffed by consulting professionals. The investment's risks and rewards will be greatly determined by the degree of the firm's commitment to the goals of the consulting practice as well as the range and level of consulting services offered.

**.02**    In addition to these concerns, this practice aid identifies the critical issues facing all CPA firms providing consulting services and discusses sound management approaches to improving profitability. It reviews such fundamental procedures as clearly defining the reasons for establishing or expanding a consulting practice and for identifying and understanding the controllable factors related to providing consulting services profitably. This practice aid suggests ways to achieve goals and monitor profitability, including techniques for managing and measuring performance.

**.03**    This practice aid illustrates the relationship between various economic principles and marketplace issues, such as target markets, skill requirements, cost structure, organizational structure, and profitability. It also discusses the management challenges and opportunities for increasing revenue and controlling the costs of consulting products.

**.04**    Additional guidance that may be useful to practitioners who wish to establish or expand consulting services practices is provided in MAS Practice Administration Aid No. 4, *Starting and Developing an MAS Practice* (New York: AICPA, 1988).

**6/110    PURPOSE AND OBJECTIVES OF  
A CONSULTING PRACTICE**

**.01**    A firm establishes a consulting services practice or expands an existing practice to meet its strategic objectives. For example, the partners may expect that offering these services will increase revenues and partners' compensation. Other objectives may be to meet market and client demand, enhance client relationships, and prevent the encroachment of competitors. For example, a firm may consider expanding its microcomputer consulting service to differentiate



itself from competitors and add value to its service relationships to foster client retention and thereby improve revenues. Some practitioners may feel compelled to move into other consulting services as a defense against competition in a specific area of consulting. Other reasons may be to recover overhead costs or to retain personnel by providing career development opportunities.

## **6/115 NATURE AND STRUCTURE OF CONSULTING SERVICES PRACTICES**

**.01** Consulting services are distinctly different from traditional accounting, auditing, and tax services. Consulting services involve a two-party relationship. According to the Statement on Standards for Consulting Services 1 issued by the AICPA's MAS Executive Committee, "The nature and scope of [consulting services] work is determined solely by the agreement between the practitioner and the client. Generally, the work is performed only for the use and benefit of the client." With respect to the firm's profitability, the most significant difference is that consulting services are usually nonrecurring. Even though an engagement may have several stages (for example, system design, computer selection, installation, implementation, and training), the consultant-client relationship often will terminate upon completion of the project. To help protect the viability of the consulting services practice, practitioners need to ensure that the function has well-focused objectives and structured business plans and that the career and financial expectations of the partners and staff are reasonable.

**.02** Successful management of a consulting practice requires a solid understanding of certain economic principles and the key factors in operating a business profitably. A consulting practice, like other professional service organizations, often operates in two competing markets simultaneously: the "output" market of professional services, and the "input" market of its professional workforce. These two markets compete for financial resources in that the high compensation expected by consulting professionals challenges the firm's ability to quote competitive engagement fees while maintaining desired profit margins. Balancing the demands and implications of these two markets is accomplished through the firm's economic and organizational structure.

**.03** The four major elements of a consulting services practice—professional work force, services, economic structure, and organizational structure—are tightly linked and can and should be planned for, directed, managed, and controlled in a thoughtful, disciplined manner. The types of consulting services provided by the firm will determine the professional skills to be recruited at a particular market price. Consulting in strategic planning, business planning, and human resources requires skills different from those used in microcomputer consulting or operational auditing services. Furthermore, consultants providing technical services may be more effective with less experience than general management consultants. However, they may also require more supervision.

**.04** The marketplace's perception of the value of particular services will have an impact on not only the practice's revenues, but also its organizational structure, utilization targets, and staffing requirements. For example, information systems consulting generally requires a high staff-to-partner ratio, while domestic litigation services require greater partner involvement. Consequently, the revenues, costs, personnel, and management associated with each practice area

are significantly different. Understanding the interrelationships of these elements and the dynamics of their constraints is the key to successful practice management.

**.05** Consulting services involve many variables, such as the complexity of services provided, the scope of engagements, and the expertise of personnel. Many of these variables can be measured or otherwise monitored according to the goals the firm has set for its consulting services function. As with traditional accounting services, benchmarks, targets, and other standards can be established to support the effective management of consulting services. Supplemented by other business indicators, measures of the achievement of the goals form the basis of a solid consulting practice management system. In addition, the "input" and "output" relationship provides a basic framework for measuring the correlation between costs and revenues. Establishing proper expectations for the service line is particularly important for a practitioner offering consulting services for the first time.

## **6/120 MANAGING THE CONSULTING SERVICES PRACTICE**

**.01** Setting appropriate performance goals and measures is vital to the effective management of consulting services. The CPA firm needs to correlate the objectives of its consulting practice with its reasons for developing or continuing this function. If the objective is to increase staff utilization during off-peak periods, the firm may expand its consulting services. The firm will determine the most appropriate method of increasing billable hours for new or existing consulting services and thereby reduce staff downtime. The alternatives available to the firm for expanding consulting activities include the analysis of client needs, identification of add-on services to existing engagements, and the development of new services to offer existing or potential clients. Similarly, if the objective is to meet the competition, the firm's goal could be to reduce the loss of clients to certain firms or to increase the number of clients that use its consulting services.

**.02** Achievement of goals should be measurable if the firm is to evaluate its success. Consequently, the firm needs to develop quantitative performance standards and a means to evaluate performance quality. The quantitative standards will vary for each consulting service. For example, the performance expectations for a business valuation engagement will be very different from the targets established for an engagement in which the practitioner provides staff on a short-term basis, such as in a bankruptcy trusteeship. Typical quantitative measures that could be used to assess engagement performance include chargeable-hour totals, chargeability percentages, and billable revenue, whereas a measure of the firm's overall performance could be the number and types of clients won or lost. In addition to quantitative measures, qualitative standards can be used to evaluate consulting practice success. For example, client satisfaction with particular consulting services can be surveyed and monitored regularly. Similarly, indicators of market penetration levels, staff morale, skill development, and personnel retention can be developed to monitor the performance of the consulting services function and its impact on the firm.

### Controllable Factors

**.03** Proper goal setting requires an organization to define its critical success factors (CSFs). CSFs are the planning and operational elements a firm identifies as contributing to the attainment of its business objectives. In addition, the organization should determine the resources required to achieve its objectives and budget accordingly. The principal resources of a firm are the expertise of its people and money. A firm manages goal achievement by identifying its objectives and carefully allocating resources and monitoring the effectiveness of their use for each consulting service activity.

**.04** For example, a firm may allocate a specific number of dollars to marketing. It can monitor whether the target audience is being reached and how many prospective clients are attracted to the firm as a direct result of the marketing effort. Similarly, the firm can spend money on a practitioner's acquisition of a new skill and measure the effectiveness of this expenditure by tracking the number of engagements in which that skill was used and the resultant revenue.

**.05** Although effective resource management is important for large and medium-sized firms, it is especially critical for individual practitioners and small firms. The small firms' actions need to be based upon a thorough understanding of the target markets, a clear sense of the costs associated with serving these markets, and realistic performance expectations.

### Critical Success Factors

**.06** Effective resource management involves the development of a plan to achieve the objectives of establishing consulting services. To achieve these objectives, the CPA firm must first identify the critical success factors that contribute to their attainment. Exhibit 6-1 in the appendix provides an example of objectives and the recommended CSFs for achieving them.

**.07** Once the CPA firm has defined the objectives and CSFs for its consulting practice, it then needs to develop techniques for managing them along with measures for monitoring the results of the consulting practice. Exhibit 6-2 in the appendix illustrates the identification of CSFs along with techniques for managing, measuring, and monitoring them. Some of the critical success factors are discussed briefly below.

### Revenue Enhancement

**.08** Accounting firms traditionally have based their fees on an hourly rate that is usually a multiple of the actual cost of salary. However, several different methods can be used to increase fees for consulting services.

**.09** **Alternative Fee Structures.** Most firms use the concept of traditional rates based on multiples of actual costs to bill for such consulting services as information systems implementation, cost analysis, and finance and management accounting services. There are, however, alternative methods for setting rates for consulting services, particularly when market-

driven prices are established by both buyers and sellers. Increasingly, practitioners are basing fees on rates that incorporate risk sharing, fixed prices, or payment for milestone achievement.

**.10** Some practitioners are charging fees well above the usual cost multiples for certain consulting services because of their timing, risk, or unique character. These fees are determined by a method called *value billing*, which uses hourly rates higher than standard rates or a premium flat rate for services that have exceptional worth to the client. These higher fees are warranted because of the special expert skills of the practitioner, usually for nonrecurring services (for example, business restructuring). Other examples of value-billing services include expert testimony, strategy consulting, operations services, and technical advice.

**.11** In addition, fees may also be based on the number of persons for whom a service is provided. For example, a fee for pension plan consulting may be based on the number of plan participants, or a fee for training and education may be determined by the number of students or seminar attendees.

**.12 Sale of Products.** The CPA firm can generate consulting services revenue by providing services associated with the sale of products. The firm may have an arrangement to serve as a vendor representative for a product.<sup>1</sup> Similarly, the firm may sell a product developed in-house, such as software, a checklist, or a manual associated with training or educational consulting. In both instances, the product's sales price may be based on its cost or dictated by marketplace competition. Profitability is often enhanced by the bundling of products with services when the firm provides both.

**.13 Additional Revenue Sources.** Consulting profitability can be enhanced through the pursuit of several additional sources of revenue. Increasingly popular are arrangements under which the firm specializes in, customizes, or otherwise adds value to hardware and software products. For example, the CPA firm may arrange to purchase and resell a dealer's products, or the dealer may provide referrals for consulting services to prospective and existing clients. The CPA firm also may split fees with a vendor for engagements in which the firm provides a portion of the service, such as training and installation, and the vendor provides the hardware or a remaining portion of the service. In such an arrangement, the firm might be paid directly by the vendor who has charged for all services and products rendered or be paid by the client for the portion of services rendered. If the CPA firm develops software in-house, it can earn licensing fees from the use of its products.

**.14** Although most consulting work is of a nonrecurring nature, some services could be marketed or structured to encourage clients to consider additional services. For example, if the firm provides recruiting services it could suggest that the client consider an engagement to review its organizational structure. The firm could also advise a client it has assisted in developing a

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<sup>1</sup> According to Ethics rule 503 (AICPA, *Professional Standards*, vol. 2, ET sec. 503.01, paragraph B), a member in public practice who is paid or expects to be paid a commission for recommending or referring a product or service shall disclose that fact to the client. This applies only to nonattest clients.

business plan that an annual review of the plan's effectiveness is beneficial. Similarly, if a consulting engagement involves the development of software or procedures, an engagement to implement the software or procedures may be an additional source of revenue, as would be a subsequent review of both the software and its operation.

### **Cost Management**

**.15** The marketplace for consulting services is very dynamic, with client needs and service requirements often changing dramatically. Complicating this environment is the trend among firms to specialize in certain services and the requirement to recruit personnel with specific technical skills to provide these services. The costs of providing consulting services in this environment are high. Therefore, practitioners or firms considering establishing or expanding a consulting services practice need to weigh the costs associated with expanding a work force with special skills to maintain a competitive marketplace position, against the benefits to be derived from the specialized services. When evaluating the costs and benefits, the firm also needs to consider the impact an investment will have on research and development, marketing, capital requirements, and staffing and training.

**.16 Research and Development.** Expanding an existing consulting practice may involve only allocating additional employee time. However, a firm may wish to develop new services or expand existing capabilities to an extent that requires a significant commitment of various firm resources.

**.17** When developing a new product or service, the firm should prepare a budget that includes estimates of both time and expenses as a basis for project approval and a means to monitor progress. Several elements of revenue and cost can be included in the budget. The firm may want to conduct an informal market survey to determine whether the business community needs a particular service or product. If the firm concludes that an idea is viable, it can proceed with collecting data on manpower requirements and costs, equipment purchases, administrative and overhead costs, and costs related to initial application and testing of the product or service.

**.18** The firm should control these costs and compare them with the original budget. Once the firm develops the product or service and knows its actual costs, it may create a method to measure the value of the research and development by correlating it with the revenues generated.

**.19 Marketing.** The firm needs to commit resources to the marketing of any product or service developed or to the consulting function itself. A commitment can be made for nonbillable time required for such activities as speaking to business organizations, writing articles for publication, and developing client relations. A financial commitment also can be made by developing promotional materials, such as advertising brochures, hiring key personnel, and purchasing capital assets. The level of firm commitment to the marketing effort will determine the amount of money and time devoted to this aspect of practice administration.

**.20 Capital Investments.** To remain competitive in the marketplace, most consulting practices use technology to deliver services. Therefore, the costs of this technology should be considered in any plans for providing consulting services. At the outset of developing a consulting practice, the costs of technology should be factored into the long-term plan. The firm

should recognize that, although outlays for hardware and software may not be associated readily with a particular client or service, it must allocate financial resources to capital acquisitions even if short-term cash flow is affected. This investment can be considered as an item that can be a direct charge to future engagements or as additional overhead costs that are factored into the billing rate. If other costs are to be incurred (such as extensive cabling or climate control equipment) these costs should be identified and included in the budget.

**.21 Staffing and Training.** The relationship between the delivery of services and the skills required to deliver them determines the approach to recruiting. Some firms may need to recruit personnel with specific expertise that is not accounting-related to perform the projected range of consulting services.

**.22** Training for consulting professionals is different, and often more costly than for professionals in the traditional accounting practice. Staff may need instruction in technical knowledge and training in the use of technology and equipment. In addition, consulting professionals often incur additional training and costs to pursue and acquire types of certifications different from those of the CPA.

**.23** Consulting services, as with traditional services, need administrative and other support staff. If the work of this staff cannot be billed to clients, the related costs must be included in the overall department cost that is applied to the billing structure. Finally, management should consider establishing job sharing or using per-diem paraprofessionals and other subcontractors to limit the fixed cost of the consulting function by paying for services only when they are required.

## 6/125 SUMMARY

**.01** Practitioners need to thoroughly understand the nature and structure of a consulting services practice in order to manage it effectively. Efforts to achieve profitability, as well as plans to establish new or expand existing consulting services, should be considered in light of the firm's structure and culture and the demands of the consulting services marketplace.

**.02** Providers of consulting services also need to clearly define their objectives in providing these services and to identify the critical success factors for achieving these objectives. Furthermore, they need to determine the management techniques that will help to manage the CSFs along with the techniques that will allow them to monitor and measure their effectiveness.

APPENDIX 6

**SAMPLE OBJECTIVES AND CRITICAL SUCCESS FACTORS**

Exhibit 6-1

**Typical Consulting Practice Business Objectives  
and Critical Success Factors for Achieving Them**

Objectives	Critical Success Factors
Increased net revenue	Focused business plans (shared vision) Effective marketing and sales Proper staff mix (capacity planning) Improved staff productivity (utilization) Increased value billing Maximum quality assurance and client satisfaction Superior project management Timely WIP and A/R management
Reduced partner and staff costs	Proper alignment of manpower with business volume Effective recruiting and retention programs Comprehensive compensation management Candid and timely performance appraisals
Lower overhead and administrative costs	Effective practice development cost control Optimal administrative support functions Elimination of inappropriate expenditures

**Increased Profit**

**Sample Techniques for Managing, Measuring, and Monitoring Critical Success Factors**

Increased Net Revenue Critical Success Factors	Management Techniques	Measurement and Monitoring Techniques
Focused business plans	Energize an existing client service development program. Encourage staff to be alert for opportunities with existing clients.	Track ideas and leads and consider in performance evaluations.
Effective marketing and sales	Establish a sales-contact reporting and tracking program. Institute a sales incentive program. Introduce special service leaders to key clients on a recurring basis.	Match the marketing efforts to the new clients obtained or services provided.
Proper staff mix (capacity planning)	Regularly examine "input" and "output" markets, and balance the two.	Develop firm forecasts.
Improved staff productivity	Examine engagement plans regularly for possible acceleration, efficiency, or leverage opportunities. Review staff assignments and workloads to minimize nonchargeable hours.	Review job estimates and compare with actual. Develop projections of hours and jobs.
Increased value billing	Build specialist skills and provide clearly superior service as a basis for higher fees. Emphasize to the staff the effect of service and quality on higher fees. Establish minimum pricing thresholds and hurdles for exceptions.	Track value billing from engagement budgets. Require estimates and compare with actual.
Maximum quality assurance and client satisfaction	Ensure involvement by specialists on all appropriate client engagements.	Track specialist hours charged to routine engagements.
Superior project management	Institute routine engagement status reporting.	Report WIP aging milestones. Compare actual to budget. Report project stages.
Timely WIP and A/R management	Bill clients monthly.	Report A/R aging. Report WIP aging.



Reduced Partner and Staff Costs Critical Success Factors	Management Techniques	Measurement and Monitoring Techniques
Proper alignment of manpower with business volume	Analyze the balance of the "input" and output" markets regularly. Institute productivity and utilization forecasts.	Compare actual to budget. Maintain chargeable hour standards.
Effective recruiting and retention programs	Target key schools and cultivate firm name recognition. Implement mentoring programs. Provide continuing education and training. Incorporate staff development into appraisal criteria at all levels.	Review performance evaluations on a regular basis.
Comprehensive compensation management	Review budget and actual staff costs regularly. Develop incentive compensation systems.	Report progress on pay-for-performance goals.
Candid and timely performance appraisals	Establish a disciplined performance appraisal process. Develop key indicators and monitor them regularly.	Set a schedule for reviews. Establish goals at beginning of the year and review them at appraisal time.

(continued)

**Sample Techniques for Managing, Measuring, and Monitoring Critical Success Factors (continued)**

Lower Overhead and Administrative Costs Critical Success Factors	Management Techniques	Measurement and Monitoring Techniques
Effective practice development cost control	<p>Implement control procedures for new sales contacts within the office.            Critically examine business development activities on a routine basis.</p>	<p>Distribute follow-up sales call results.            Tally and report on lead generation from development activities.</p>
Elimination of inappropriate expenditures	<p>Establish overhead budgets and monitor expenses closely.            Provide effective purchase order control.</p>	<p>Use both general ledger and project cost accumulation. Issue reports with comparatives.</p>
Optimal administrative support functions	<p>Delegate more functions to the administrative staff.            Expand paraprofessional roles and responsibilities.            Invest in more effective technology for support activities.            Promote efficient use of automation technology.            Ensure the effectiveness of collection management.            Develop key indicators and measure regularly.</p>	<p>Compare budgeted hours of support staff on jobs with actual.</p>

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**READER'S RESPONSES TO *MANAGING CONSULTING SERVICES: A FOCUS ON PROFITABILITY***

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<i>Improving Productivity Through Work Measurement: A Cooperative Approach</i>	055107
<i>EDP Engagement: Implementation of Data Processing Systems Using Mainframes or Minicomputers</i>	055111
<i>Conversion to a Microcomputer-Based Accounting System</i>	055126
<i>Assisting Clients in Developing an Employee Handbook</i>	055127
<i>Microcomputer Security</i>	055128
<i>Microcomputer Training</i>	055129
<i>Disaster Recovery Planning</i>	055130

(continued)

<i>Title</i>	<i>Product Number</i>
<i>Automating Small and Medium-Sized Businesses in Selected Industries</i>	<b>055136</b>
<i>Preparing Financial Models</i>	<b>055137</b>
<i>Selecting a Telecommunications System</i>	<b>055138</b>
<b>Practice Administration Aids Series</b>	
<i>Developing an MAS Engagement Control Program</i>	<b>055802</b>
<i>Cooperative Engagements and Referrals</i>	<b>055906</b>
<i>Written Communication of Results in MAS Engagements</i>	<b>055910</b>
<i>Starting and Developing an MAS Practice</i>	<b>055925</b>
<i>Communicating With Clients About MAS Engagement Understandings</i>	<b>055930</b>
<i>Human Resources Planning and Management for an MAS Practice</i>	<b>055131</b>
<i>Managing Consulting Services: A Focus on Profitability</i>	<b>055144</b>
<b>Industry Consulting Practice Aids Series</b>	
<i>Restaurants and Food-Service Establishments</i>	<b>055132</b>
<i>Law Firms</i>	<b>055135</b>
<i>Voluntary Health and Welfare Organizations</i>	<b>055142</b>
<b>Special Reports</b>	
<i>Operational Audit Engagements</i>	<b>029193</b>
<i>Introduction to Local Area Network Concepts and Terminology</i>	<b>048456</b>
<i>Study of MAS Practice and Knowledge</i>	<b>048550</b>
<i>An Introduction to Artificial Intelligence and Expert Systems</i>	<b>048570</b>
<i>Comparing Attest and Management Advisory Services: A Guide for the Practitioner</i>	<b>048599</b>
<i>Introduction to Natural Language Processing</i>	<b>048560</b>
<i>Using Graphics to Enhance MAS Presentations</i>	<b>048561</b>
<i>Mass Storage Technology</i>	<b>048600</b>
<b>Software (running on WordPerfect 5.1)</b>	
<i>Small Business Consulting Tool: Diagnostic Review Checklist for Maximizing Profits</i>	<b>055010</b>

To obtain any of these practice aids, call the AICPA Order Department: 1-800-334-6961 (USA) or 1-800-248-0445 (NY).

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